



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SHAHID HAQUE,
Plaintiff,

C.A. No. 12651 - VCS

v.

TESLA MOTORS, INC.,
Defendant.

PLAINTIFF'S OPENING TRIAL BRIEF

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GLOSSARY

ABBREVIATION	DESCRIPTION
“Answer”	Tesla’s Answer to Verified Complaint Pursuant to 8 <i>Del. C. § 220</i> , September 6, 2016
“April 4, 2016 Announcement”	Tesla’s press release, dated April 4, 2016
“Board”	Tesla’s Board of Directors
“February 20, 2013 Shareholder Letter”	Tesla Letter to Shareholders for the 2012 Q4 and full year 2013
“February 11, 2015 Shareholder Letter”	Tesla Letter to Shareholders for the 2014 Q4 and full year 2014
“February 11, 2015 Conference Call”	Tesla 2014 Q4 Earnings Conference Call Transcript, dated February 11, 2015
“February 10, 2016 Shareholder Letter”	Tesla Letter to Shareholders for the 2015 Q4 and full year 2015
“FY 2015 Annual Report”	Tesla’s annual report for fiscal year 2015, dated February 24, 2016
“June 15, 2015 Demand”	Plaintiff’s Section 220 demand letter, dated June 15, 2015
“July 31, 2014 Shareholder Letter”	Tesla Letter to Shareholders for the 2014 Q2
“July 3, 2016 Announcement”	Tesla’s press release, dated July 3, 2016
“July 18, 2016 Demand”	Plaintiff’s second Section 220 demand letter, dated July 18, 2016
“May 7, 2014 Shareholder Letter”	Tesla Letter to Shareholders for the 2014 Q1

ABBREVIATION	DESCRIPTION
“May 6, 2015 Shareholder Letter”	Tesla Letter to Shareholders for the 2015 Q1
“May 4, 2016 Shareholder Letter”	Tesla Letter to Shareholders for the 2016 Q1
“Musk”	Elon Musk
“November 5, 2014 Conference Call”	Tesla 2014 Q3 Earnings Conference Call Transcript, dated November 5, 2014
“November 5, 2014 Shareholder Letter”	Tesla Letter to Shareholders for the 2014 Q3
“Section 220”	8 <i>Del. C.</i> § 220
“Tesla” or the “Company”	Tesla Motors, Inc.

PRELIMINARY STATEMENT

Tesla's stock sells on a singular, but dazzling, promise: that the Company will one day become the leader in the manufacture of mass market electric vehicles. Yet, despite this almost limitless promise, Tesla has at various times missed the sales guidance it has provided to the market and has only sold fewer than 140,000 vehicles since its initial public offering in June 2010.

When questions have arisen about the true level of demand for Tesla's electric vehicles, Tesla has frequently blamed sales misses on various production constraints, suggesting that, without these production constraints, Tesla would have been able to produce and sell more cars. However, based on Plaintiff's and his counsel's investigation, there is a credible – indeed, compelling – basis for inferring that Tesla and its officers and directors have fabricated the existence of many of these production constraints, that Tesla in fact has more production capacity than it has let on, and that shareholders are thereby being affirmatively misled as to the true level of demand for Tesla's cars.

Numerous red flags suggest that Tesla has misled shareholders concerning the existence of these purported production constraints.

First, Tesla's reported production figures fluctuate erratically from quarter to quarter, instead of rising steadily from quarter to quarter, as one would expect from a production-constrained company that sorts through production issues over time.

For example, in the space of one quarter, from the 2014 Q3 (third quarter) to the 2014 Q4 (fourth quarter), Tesla reported a staggering 61% increase in production. This was not coincidental, because it allowed the Company to reach a very specific milestone of producing 35,000 cars in one year, a target the Company had repeatedly touted to shareholders. After just setting this record quarterly production figure, however, Tesla then guided investors that production in the next quarter, the 2015 Q1, would be *14% less*. These facts do not so much suggest a company facing production constraints, as a company with *excess capacity* – one that is able to *manipulate* production to hit specific targets or to meet specific levels of anticipated demand.

Second, several of Tesla's explanations of production constraints have been belated and contradict the Company's own prior statements during the same quarter. For example, in the 2016 Q1 and then again in the 2016 Q2, Tesla blamed sales misses on various production constraints. However, in each instance, *halfway* through the corresponding quarter, the Company had publicly assured shareholders that production was proceeding smoothly and was on target. It is inconceivable that Tesla would not have known about the existence of potential production issues *halfway* through the quarter, before updating shareholders. The only logical inference is that Tesla's belated explanations of production constraints are false.

Third, Tesla has offered explanations of production constraints that are patently implausible. Among the more frequently-invoked excuses, Tesla's senior management has cited steep production "ramps" for causing bottlenecks that result in missed sales targets. For example, in the 2016 Q2, Tesla missed its sales target of 17,000 vehicles, blaming the miss on an "extreme production ramp," which resulted in half of that quarter's production occurring in the last month. This, in turn, supposedly resulted in cars still being shipped, which cars could not be recorded as sales. However, the explanation of an "extreme production ramp" during the quarter is simply implausible. Based on its own public filings, entering the 2016 Q2, *Tesla already had enough production capacity to meet the 17,000 sales target.* Therefore, even without a production "ramp," Tesla should have been able to meet the 17,000 sales target, but failed to do so.

Fourth, Tesla has recycled excuses of production constraints that it used in the past. These excuses have now been shown to be false. For example, in the 2015 Q1, Tesla provided a lower production guidance figure than it had for the 2014 Q4, explaining that it needed to conduct a factory shut-down to give workers "rest." Putting aside the question of why a company with insatiable demand would have insufficient able-bodied personnel, a recently-published biography of Musk, Tesla's chief executive officer, reveals that Tesla also used this excuse in early 2013 to mislead shareholders. According to the biography, Musk made the

decision in early 2013 to “rest” workers, *i.e.*, shut down the factory, because the *Company could not sell any cars*. In fact, Tesla was in such dire financial straits that Musk offered to sell the Company to Google.

Fifth, corroborating the conclusion that Tesla in fact has *more* manufacturing capacity than it has let on, Tesla frequently is unable to complete deliveries of cars that it manufactures in a quarter. For example, when Tesla manufactured a record number of cars in the 2014 Q4, allowing the Company to hit its 35,000 production milestone, Tesla reported that it could not deliver all those cars, and therefore could not record them as sales. This obviously raised concerns about whether the demand for Tesla’s cars was real. To address these concerns, Tesla conjured a whole set of *additional* excuses, namely that: customers were absent and unable to take delivery due to holidays; Tesla was unable to complete deliveries because of winter storms; and Tesla was unable to complete deliveries because of shipping problems.

The above red flags are all the more troubling in the last year because of an unprecedented exodus of executives from all the key Tesla departments that would be implicated by the misconduct suggested by the above red flags. Specifically, there have been at least seven key executive departures from Tesla’s finance department, manufacturing department, media communications, and legal

department in just the past twelve months alone, leading some to compare Tesla with Valeant before it imploded.

Under Section 220, a shareholder has a proper purpose in investigating whether a Delaware corporation, and its directors and officers are misleading shareholders about the corporation's financial performance. Here, Plaintiff has established not just a credible basis, but indeed a compelling basis, for inferring misconduct and seeking the production of the appropriate books and records.

Where a shareholder demonstrates a credible basis for inferring misconduct, a Delaware corporation is required to produce documents under Section 220, and cannot mount a "merits" defense in lieu of producing documents. Yet, that is what Tesla has repeatedly done here.

In numerous communications with Plaintiff's counsel, Tesla has raised the merits defense that its sales are real, going so far as to produce 878 pages of irrelevant documents to demonstrate that the sales reported by Tesla in fact occurred. Not only is this an improper merits defense "subversive" of the process contemplated by Section 220, it also misses the point. Plaintiff is not questioning whether Tesla is *inflating* its sales figures. To the contrary, Plaintiff is questioning whether Tesla is misleading shareholders as to the reasons why Tesla's sales figures are so *low*. Despite ample opportunity, even to this day, Tesla and its counsel refuse to give Plaintiff any books and records relating to Tesla's

production, production capacity, or the existence of the production constraints cited by Tesla.

For the reasons discussed herein, the Court should compel Tesla to produce responsive books and records, and award Plaintiff his reasonable attorneys' fees and costs.

STATEMENT OF FACTS

I. THE PARTIES

Plaintiff Shahid Haque is a shareholder of Tesla and has continuously owned shares in the common stock of the Company since April 24, 2014.¹

Tesla is a Delaware corporation headquartered in Palo Alto, California. Tesla went public via an initial public offering in 2010, and its shares trade on the NASDAQ exchange under the symbol "TSLA."²

At all times relevant to this Complaint, Elon Musk was the Product Architect, Chief Executive Officer and Chairman of Tesla's Board.³

¹ PX 28, July 18, 2016 Demand at Ex. B (Verification of Shahid Haque, sworn to July 18, 2016). References to exhibits in Plaintiff's trial briefs are cited as "PX ___"). At the time of his first Section 220 demand, dated June 15, 2015, Plaintiff had owned Tesla stock continuously since August 15, 2013. Subsequent to this first demand, and before making his second demand, Plaintiff disposed of his stock that had been acquired on August 15, 2013.

² PX 35, Answer No. 11.

³ PX 35, Answer No. 12; PX 22, FY 2015 Annual Report at 20 ("We are highly dependent on the services of Elon Musk, our Chief Executive Officer, Product Architect, Chairman of our Board of Directors and largest stockholder.").

II. TESLA'S HISTORY AND BACKGROUND

Tesla designs, develops, manufactures and sells fully electric vehicles and energy storage products. The Company has its own network of vehicle sales and service centers and operates “Supercharger” stations globally for recharging its electric vehicles.⁴

Tesla currently produces and sells two fully electric vehicles, the Model S sedan and the Model X sport utility vehicle (SUV). Tesla commenced deliveries of the Model S in June 2012. Tesla commenced customer deliveries of Model X in the 2015 Q3. Tesla conducts vehicle manufacturing and assembly operations from its facilities in Fremont, California; Lathrop, California; and Tilburg, Netherlands.⁵

Every quarter, Tesla reports, and its shareholders closely monitor, two key metrics: (a) the number of vehicles that were actually produced (manufactured) in the quarter; and (b) the number of vehicle sales, which Tesla recognizes when a vehicle is delivered to a customer and the paperwork is checked and completed.⁶ Investors focus intensely on deliveries because Tesla's cumulative deliveries to date are just a tiny fraction of what the established automotive companies produce in a given year. By way of comparison, between the date of its launch in June 2012 and December 31, 2015, Tesla had delivered just over 107,000 new Model S

⁴ PX 35, Answer No. 13.

⁵ *Id.*

⁶ PX 26, July 3, 2016 Announcement at 1.

vehicles worldwide.⁷ As of the end of the 2016 Q2, Tesla had sold less than 140,000 vehicles, including both the Model S and the Model X.⁸ In contrast, General Motors Company sold 9.8 million vehicles in 2015 alone.⁹

Tesla is aware of the importance of these two metrics to its shareholders. Among other things, Tesla internally monitors its production capacity. For example, in its FY 2015 Annual Report, Tesla disclosed that it had “completed significant investments to increase our production capacity and to begin production of the Model X at the Tesla Factory.”¹⁰

Moreover, Tesla and Musk frequently address these metrics when reporting to shareholders. In particular, Tesla and Musk have repeatedly stressed in communications with shareholders that Tesla is not experiencing any problems with demand for Tesla’s vehicles, and that Tesla’s growth is constrained only by the lack of manufacturing capacity to satisfy this demand. For example, in the July 31, 2014 Shareholder Letter, Tesla stated that “global delivery wait times increased

⁷ PX 22, FY 2015 Annual Report at 4.

⁸ As of December 31, 2015, Tesla had delivered 107,000 vehicles. *See* PX 22, FY 2015 Annual Report at 4. In the first quarter of 2016, Tesla delivered 14,810 vehicles. *See* PX 24, May 4, 2016 Shareholder Letter at 3. In the second quarter of 2016, Tesla delivered 14,370 vehicles (an additional 5,150 vehicles were in transit). *See* PX 26, July 3, 2016 Announcement at 1. Thus, as of the end of the 2016 Q2, Tesla had delivered a total of 136,180 vehicles (107,000 + 14,810 + 14,370).

⁹ PX 20, General Motors Co. Press Release, January 21, 2016 at 1.

¹⁰ PX 22, FY 2015 Annual Report at 9.

because our production growth was unable to keep pace with increased demand.”¹¹ Similarly, in the November 5, 2014 Shareholder Letter, Tesla stated that “[b]eing unable to increase production fast enough, not lack of demand, is a fair criticism of Tesla.”¹² On the shareholder conference call held on the same day, Musk reiterated that “[p]roduction is our issue and being too perfectionist about future products those are legitimate things to be concerned about, but not demand.”¹³ Again, in the February 11, 2015 Shareholder Letter, Tesla stated that “we remain production constrained” but that “both vehicle production and demand are expected to accelerate in 2015.”¹⁴

III. TESLA’S MISSED DELIVERIES IN 2016

A. Tesla’s 2016 Q1 Deliveries Miss

Nearly *halfway through the 2016 Q1*, Tesla issued the February 10, 2016 Shareholder Letter in which the Company forecasted that, in “[2016] Q1, we plan to grow deliveries 60% year on year to approximately 16,000 vehicles.”¹⁵ In the letter, Tesla noted some production issues had occurred in January. However, the Company reassured shareholders that these issues now had been resolved.¹⁶

¹¹ PX 5, July 31, 2014 Shareholder Letter at 2.

¹² PX 6, November 5, 2014 Shareholder Letter at 2.

¹³ PX 7, November 5, 2014 Conference Call at 3.

¹⁴ PX 9, February 11, 2015 Shareholder Letter at 3, 1.

¹⁵ PX 21, February 10, 2016 Shareholder Letter at 4.

¹⁶ *Id.* at 2.

Less than two months later, in the April 4, 2016 Announcement, Tesla revealed that it had missed its guidance of 16,000 deliveries, instead delivering (selling) just 14,820 vehicles in the 2016 Q1. Tesla attributed the lower delivery number to production constraints, stating that “[t]he Q1 delivery count was impacted by severe Model X supplier parts shortages in January and February that lasted much longer than initially expected.”¹⁷

B. Tesla’s 2016 Q2 Deliveries Miss

Almost halfway through the 2016 Q2, Tesla issued the May 4, 2016 Shareholder Letter forecasting that it expected to manufacture 20,000 vehicles in the 2016 Q2 and deliver 17,000 vehicles. Tesla explained this optimism, stating: “now that supply chain constraints have been *resolved*, we plan to exit Q2 at a steady production rate of 2,000 vehicles per week.”¹⁸ (emphasis added). Tesla did not mention any production issues, or the need for any production “ramps” in order to hit these production and delivery figures.

However, just two months later, Tesla announced in the July 3, 2016 Announcement that it produced 18,345 vehicles in the 2016 Q2, and that deliveries (sales) were “lower than anticipated at 14,370 vehicles, consisting of 9,745 Model

¹⁷ PX 23, April 4, 2016 Announcement at 1.

¹⁸ PX 24, May 4, 2016 Shareholder Letter at 3.

S and 4,625 Model X.”¹⁹ The 14,370 deliveries represented a quarter-on-quarter drop from the 2016 Q1 deliveries of 14,810 vehicles, and also missed by over 15% the Company’s forecast of 17,000 deliveries.

In the July 3, 2016 Announcement, Tesla again blamed production issues for the low 2016 Q2 deliveries number. Specifically, Tesla blamed an “extreme production ramp in Q2,” which purportedly resulted in “almost half of the quarter’s production occur[ing] in the final four weeks.” According to Tesla, this resulted in a “high mix of customer-ordered vehicles still on trucks and ships at the end of the quarter,” totaling 5,150 vehicles.²⁰

IV. TESLA’S MISSED PRODUCTION AND/OR MISSED DELIVERIES IN PRIOR YEARS

A. Tesla’s Reported Production And Deliveries For The 2014 Q3

In the July 31, 2014 Shareholder Letter, Tesla announced that it was “adding new production capacity at our Fremont factory that will allow us to meet the growing worldwide demand for our vehicles,” and that this added capacity would allow the Company to exceed total production of 35,000 vehicles in 2014.²¹ For the 2014 Q3, Tesla stated that it planned to produce 9,000 vehicles and deliver 7,800 vehicles. Tesla explained that these targets were actually lower than the

¹⁹ PX 26, July 3, 2016 Announcement at 1.

²⁰ *Id.*

²¹ PX 5, July 31, 2014 Shareholder Letter at 1.

number the Company theoretically could have achieved, because the targets “take[] into account the effect of the two-week production shutdown related to the transition to the new final assembly line at the Fremont factory.” Without this interruption, Tesla claimed, 2014 Q3 production and deliveries would have been even higher, at 11,000 and 9,500 vehicles, respectively.²²

On November 5, 2014, Tesla reported its 2014 Q3 results. Tesla reported that it delivered 7,785 vehicles in the 2016 Q3, consistent with the prior guidance of 7,800 vehicles.²³ However, Tesla reported production of only 7,200 vehicles, 1,800 less than the 9,000 guidance.²⁴ Tesla blamed the lower production on the retooling shutdown in the 2014 Q3. Specifically, Tesla explained that the production shutdown lasted nearly a month, twice as long as previously predicted, costing manufacturing output of an additional 2,000 vehicles.²⁵

However, Tesla did not explain why the extra two-week shutdown reduced production by an extra 2,000 vehicles, but did not equally hurt deliveries, which came in almost exactly on target.

²² *Id.* at 4.

²³ PX 6, November 5, 2014 Shareholder Letter at 1.

²⁴ PX 7, November 5, 2014 Conference Call at 6.

²⁵ PX 6, November 5, 2014 Shareholder Letter at 2.

B. Tesla's Reported Production And Deliveries For The 2014 Q4

On February 11, 2015, Tesla announced its 2014 Q4 results. Tesla reported that it manufactured 11,627 vehicles in the 2014 Q4, a staggering **61%** increase from the 7,200 vehicles purportedly produced in the 2014 Q3.²⁶

Not coincidentally, with the 11,267 figure, Tesla was able to report a total production of 35,125 vehicles for 2014. This allowed Tesla to hit its much-touted guidance of producing 35,000 vehicles in 2014, guidance that Tesla previously announced on July 31, 2014 and affirmed on November 5, 2014.²⁷

However, Tesla was unable to sell (deliver) all the 11,627 vehicles produced in the 2014 Q4. For the quarter, Tesla was able to deliver only 9,834 vehicles. To explain this large gap, Tesla stated that “delivering those cars was physically impossible due to a combination of customers being on vacation, severe winter weather and shipping problems (with actual ships). As a result, about 1,400 vehicles slipped December and were delivered in Q1.”²⁸

However, Tesla relied on a similar explanation for lower deliveries two years previously, in the 2012 Q4. For that quarter, Tesla also blamed its lack of deliveries on the holiday season, stating:

²⁶ PX 9, February 11, 2015 Shareholder Letter at 1.

²⁷ PX 5, July 31, 2014 Shareholder Letter at 1-2; PX 6, November 5, 2014 Shareholder Letter at 3.

²⁸ PX 9, February 11, 2015 Shareholder Letter at 1.

In the quarter, we also began to scale our delivery strategies. Both personal home delivery and factory pickup were very popular delivery options for customers. However, we faced some challenges scheduling deliveries near the end of Q4 as our peak production coincided with vacations during the holiday season.²⁹

This explanation has now been demonstrated to be false. *See infra* Section Argument, Section I.D.2.

C. Tesla's Production And Deliveries For the 2015 Q1

Despite just reporting a record production of 11,627 vehicles in the 2014 Q4, Tesla guided for production of only 10,000 vehicles for the 2015 Q1, or 14% less.³⁰ This raised the question whether Tesla was deliberately under-reporting production for the 2015 Q1 because of its concerns about how many cars it could sell in the quarter, especially because of the large number of residual, unsold cars from the 2014 Q4.

To explain the 14% production drop, Tesla stated that this was “due to [the 2015 Q1] being a shorter quarter than in Q4 [2014] and approximately a week of factory downtime to allow the workforce to rest and tooling upgrades.”³¹ During the conference call held on the same day, Musk reiterated this explanation, that the

²⁹ PX 2, February 20, 2013 Shareholder Letter at 1.

³⁰ PX 9, February 11, 2015 Shareholder Letter at 4.

³¹ *Id.*

2015 Q1 was shorter than the 2014 Q4 by “one week” and that, additionally, the Company needed to rest its workforce one week.³²

However, the 2015 Q1 is only shorter than the 2014 Q4 by two days, not one week. In addition, Tesla used a similar explanation two years previously. In the February 20, 2013 Shareholder Letter, Tesla also cited worker “rest” for why the 2013 Q1 delivery numbers would be lower than in the preceding quarter, stating “[w]e expect to start the year with about 4,500 deliveries in Q1, as we gave the manufacturing team the first week of the year off to celebrate their accomplishments during 2012.”³³ However, this explanation has now been demonstrated to be false. *See infra* Argument, Section I.D.3.

V. PLAINTIFF’S DEMAND

A. Plaintiff’s June 15, 2015 Demand

On June 15, 2015, after several months of investigation, including a review of Tesla’s public filings and its officers’ statements on conference calls and in press releases, Plaintiff sent a demand seeking to inspect the Company’s books and records under Section 220. Plaintiff sought documents relating to the misconduct described herein, in order to investigate possible breaches of fiduciary duty and mismanagement by the officers of the Company in order to determine whether a

³² PX 10, February 11, 2015 Conference Call at 13.

³³ PX 2, February 20, 2013 Shareholder Letter at 4.

derivative action is warranted, and if so, whether a pre-suit demand would be excused.³⁴

In the June 15, 2015 Demand, Plaintiff requested that the Company produce or allow the inspection of the following categories of books and records:

- (1) All books and records dated or created during the Relevant Period [defined in the June 15, 2015 Demand as January 1, 2014 through the present] related to any proceedings of Tesla's Board or a committee of the Board, if those proceedings in any way relate to demand for Tesla's vehicles, orders for Tesla's vehicles, Tesla's production, Tesla's capacity, Tesla's deliveries and sales, and Tesla's inventory (collectively, Tesla's "Financial Performance").
- (2) All books and records dated or created during the Relevant Period related to the manner by which the Company accounts for orders for Tesla's vehicles, Tesla's production, Tesla's capacity, Tesla's deliveries and sales, and Tesla's inventory.
- (3) All books and records dated or created during the Relevant Period related to the Company's purported production shutdowns in the 2014 3Q and 2015 1Q.
- (4) All books and records dated or created during the Relevant Period related to the Company's disclosures, in its financial statements, proxy statements and other filings with the Securities and Exchange Commission, regarding the Company's Financial Performance.
- (5) All books and records dated or created during the Relevant Period related to any investigation at the Company or of the Company related to the Company's Financial Performance.³⁵

³⁴ PX 16, June 15, 2015 Demand.

³⁵ *Id.*

B. Tesla's Improper Rejection of Plaintiff's June 15, 2015 Demand

On July 21, 2015, Tesla rejected Plaintiff's right to inspect the demanded books and records of the Company, contending that Plaintiff did not have a proper purpose for seeking the Company's books and records and, specifically, that Plaintiff had not established a credible basis for suspecting wrongdoing.³⁶ Tesla also contended that the categories of documents sought in Plaintiff's June 15, 2015 Demand were too broad or otherwise objectionable. However, in the months following Tesla's rejection of the June 15, 2015 Demand, Plaintiff's counsel further corresponded and conducted conference calls with Tesla's counsel in order to resolve the Company's objections.

On October 13, 2015, Tesla made a production of 878 pages of documents.³⁷ However, the documents did not relate to Tesla's production capacity, but instead contained irrelevant sales data that did not address the June 15, 2015 Demand.

On October 16, 2015, Plaintiff requested that Tesla address the deficiencies with respect to the October 13, 2015 production.³⁸

On a subsequent conference call, Tesla's counsel argued, incredibly, that the Company did not measure "production capacity" and that this concept was nowhere discussed in Tesla's SEC filings. However, in its FY 2015 Annual

³⁶ PX 17, Tesla's Letter to Plaintiff, dated July 21, 2015.

³⁷ PX 35, Answer No. 79.

³⁸ PX 18, Plaintiff's Letter to Tesla, dated October 16, 2015.

Report, Tesla disclosed that it had “completed significant investments to increase our production capacity and to begin production of the Model X at the Tesla Factory.”³⁹

On December 17, 2015, Tesla sent a letter again rejecting Plaintiff’s right to inspect the demanded books and records of the Company, contending that Plaintiff did not have a credible basis for suspecting wrongdoing.⁴⁰ Tesla stated that the Company would not further respond to Plaintiff’s June 15, 2015 Demand.

C. Plaintiff’s July 18, 2016 Demand

On July 18, 2016, based on new developments, Plaintiff sent a second demand to inspect the Company’s books and records under Section 220.⁴¹ In this second demand, Plaintiff requested the Company produce or allow the inspection of the following documents:

- (1) All books and records dated or created during the Relevant Period [defined in the July 18, 2016 Demand as January 1, 2016 through the present] related to any proceedings of Tesla’s Board or a committee of the Board, if those proceedings in any way relate to Tesla’s electric vehicle production capacity, Tesla’s forecast production, Tesla’s actual production, Tesla’s capacity utilization, any purported production constraints, and Tesla’s actual deliveries (sales).
- (2) Internal reports and analyses related to Tesla’s electric vehicle production capacity, Tesla’s forecast production, Tesla’s actual

³⁹ PX 22, FY 2015 Annual Report at 9.

⁴⁰ PX 19, Tesla’s Letter to Plaintiff, dated December 17, 2015.

⁴¹ PX 28, July 18, 2016 Demand.

production, Tesla's capacity utilization, any purported production constraints, and Tesla's actual deliveries.

- (3) Books and records sufficient to support the statements made by Tesla in the February 10, 2016 Shareholder Letter, April 4, 2016 Announcement, May 4, 2016 Shareholder Letter, and July 3, 2016 Announcement concerning Tesla's electric vehicle production capacity, Tesla's forecast production, Tesla's actual production, and Tesla's purported production constraints.
- (4) Books and records dated or created during the Relevant Period related to the purported "supplier parts shortages" experienced in January and February of 2016, which Tesla described in the April 4, 2016 Announcement as responsible for delivery shortfalls in the 2016 Q1.
- (5) Books and records dated or created during the Relevant Period related to the purported "extreme production ramp" in the 2016 Q2, as described in the July 3, 2016 Announcement.⁴²

D. Tesla Refuses To Produce Books And Records In Response To the July 18, 2016 Demand

On July 25, 2016, Tesla responded to the July 18, 2016 Demand, asserting that Plaintiff failed to articulate a credible basis for inferring wrongdoing, and that the requests in the demand were "overbroad" and "otherwise objectionable."⁴³ Nevertheless, Tesla's counsel stated that "the Company will undertake to search for documents sufficient to address Mr. Haque's central thesis that 'faltering

⁴² *Id.*

⁴³ PX 29, Tesla's Letter to Plaintiff, dated July 25, 2016.

demand’ in Q1 and Q2 2016 caused the Company to ‘concoct’ production challenges.’⁴⁴

Tesla phrased its “undertaking” deliberately vaguely, and did not commit to produce any of the specific categories of documents set forth in the July 18, 2016 Demand.

On July 27, 2016, Plaintiff sent a further letter to Tesla seeking clarification and confirmation from Tesla whether it intended to produce the specific books and records requested in the July 18, 2016 Demand.⁴⁵ Tesla’s counsel responded the same day, stating that the partner in charge, Dean Kristy, was on vacation until August 8, 2016 and would not respond until then.⁴⁶

Tesla’s counsel failed to respond with any clarification or confirmation on August 8, 2016, or at any time thereafter. As of the date of this filing, Tesla has never clarified whether it was willing to produce the specific categories of books and records requested in Plaintiff’s July 18, 2016 Demand, necessitating this books and records action.

⁴⁴ *Id.*

⁴⁵ PX 30, Plaintiff’s Letter to Tesla, dated July 27, 2016.

⁴⁶ PX 31, Email from Tesla’s counsel, dated July 27, 2016.

LEGAL ARGUMENT

I. PLAINTIFF STATES A PROPER PURPOSE FOR SEEKING INSPECTION OF TESLA’S BOOKS AND RECORDS

A. Applicable Legal Standard

Under Delaware law, a stockholder is entitled to inspect corporate books and records where the stockholder: (1) shows a proper purpose; and (2) complies with the procedural requirements of Section 220.⁴⁷ Here, Tesla argues that Plaintiff failed to state a proper purpose.

Investigations into breaches of fiduciary duties, mismanagement, and wrongdoing are “well established” proper purposes.⁴⁸ “Such investigations are proper, because where the allegations of mismanagement prove meritorious, investigation furthers the interest of all stockholders and should increase stockholder return.”⁴⁹

To demonstrate a proper purpose, a shareholder is “not required to prove by a preponderance of the evidence” that the wrongdoing “actually occur[ed].”⁵⁰

⁴⁷ *Sec. First Corp. v. U.S. Die Casting and Dev. Co.*, 687 A.2d 563, 568 (Del. 1997).

⁴⁸ *See Seinfeld v. Verizon Commc’ns, Inc.*, 909 A.2d 117, 121 (Del. 2006) (“[i]t is well established that a stockholder’s desire to investigate wrongdoing or mismanagement is a ‘proper purpose’”); *City of Westland Police & Fire Ret. Sys. v. Axcelis Techs, Inc.*, 1 A.3d 281, 287 (Del. 2010) (“[o]ur law recognizes investigating possible wrongdoing as a ‘proper purpose’”).

⁴⁹ *Seinfeld*, 909 A.2d at 121.

⁵⁰ *Id.* at 123 (internal quotation marks and citation omitted).

Such a requirement “would completely undermine the purpose of Section 220 proceedings, which is to provide shareholders the access needed to make that determination in the first instance.”⁵¹ Instead, a shareholder need only show “a *credible basis* from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation – a showing that may ultimately fall well short of demonstrating that anything wrong occurred.⁵² Under Delaware law, this threshold for establishing a “credible basis” is extremely low.⁵³ Indeed, the “only way to reduce the burden of proof further would be to eliminate any requirement that a stockholder show some evidence of possible wrongdoing.”⁵⁴

The credible basis standard “may be satisfied by a credible showing through documents, logic, testimony or otherwise, that there are legitimate issues of wrongdoing.”⁵⁵ In determining whether the credible basis standard is satisfied, the

⁵¹ *La. Mun. Police Employees’ Ret. Sys. v. Countrywide Fin. Corp.*, No. Civ.A. 2608-VCN 2007 WL 2896540, at *12 (Del. Ch. Oct. 2, 2007).

⁵² *Seinfeld*, 909 A.2d at 123 (emphasis added; internal quotation marks and citations omitted); see also *Sec. First Corp.*, 687 A.2d at 568 (“a stockholder must present some credible basis from which the court can infer that waste or mismanagement may have occurred”); *Khanna v. Covad Commc’ns Group, Inc.*, 20481-NC, 2004 WL 187274 (Del. Ch. Jan. 23, 2004) (same).

⁵³ *Seinfeld*, 909 A.2d at 123 (finding that “the credible basis standard sets the *lowest possible burden of proof*”) (emphasis added).

⁵⁴ *Id.*; see also *La. Mun. Police Employees’ Ret. Sys. v. Lennar Corp.*, CIV.A. 7314-VCG, 2012 WL 4760881, at *2 (Del. Ch. Oct. 5, 2012).

⁵⁵ *Seinfeld*, 909 A.2d at 121 (emphasis added; internal quotation marks and citations omitted).

court looks at allegations collectively.⁵⁶ The court may also rely on circumstantial evidence and consider hearsay statements if they are sufficiently reliable.⁵⁷ Here, not only is Plaintiff's purpose proper, but Plaintiff has also established a credible basis for inferring that Tesla's officers and directors have misled investors, and have thus breached their fiduciary duty of loyalty to the Company's shareholders.

B. Plaintiff's Purpose Is Indisputably Proper

Plaintiff seeks to investigate whether Tesla's officers and directors have breached their fiduciary duties by issuing misleading statements about the Company's production, production capacity, and constraints on production, in order to create a false picture of the level of demand for Tesla's vehicles. It is well settled under Delaware law that corporate fiduciaries can breach their duty of loyalty "by making a materially false statement, by omitting a material fact, or by making a partial disclosure that is materially misleading."⁵⁸ "Whenever directors communicate publicly or directly with shareholders about the corporation's affairs, with or without a request for shareholder action, directors have a fiduciary duty to shareholders to exercise due care, good faith and loyalty. It follows *a fortiori* that

⁵⁶ See, e.g., *Paul v. China MediaExpress Holdings, Inc.*, C.A. No. 6570-VCP, 2012 WL 28818, at *1, 4 (Del. Ch. Jan. 5, 2012) (finding plaintiff identified a credible basis for a Section 220 demand where evidence included "numerous third-party media reports," the noisy resignations of three board members" and a publicly announced "internal investigation").

⁵⁷ *Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 778 (Del. Ch. 2016).

⁵⁸ *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 916 (Del. Ch. 1999).

when directors communicate publicly or directly with shareholders about corporate matters the *sine qua non* of directors' fiduciary duty to shareholders is honesty."⁵⁹

C. There Is A Credible Basis To Infer That Tesla Misled Shareholders As To The Reasons For Missed Deliveries In 2016

1. Tesla's Explanations For Missed Deliveries In The 2016 Q1 Are Implausible And Contradict The Company's Prior Statements

Halfway through the 2016 Q1, Tesla forecast that it would increase deliveries (sales) in that quarter to about 16,000 vehicles, a 60% increase over the prior year quarter.⁶⁰ In the same announcement, Tesla noted there had been production issues in January, but the Company reassured shareholders that those issues had been resolved: "We are already seeing improvement from these efforts and *we are now significantly increasing our Model X production throughout the balance of the quarter.* We anticipate approaching a Model X production rate of 1,000 vehicles a week in Q2."⁶¹

⁵⁹ *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998). See also *In re Nine Sys. Corp. S'holders Litig.*, No. 3940-VCN, 2013 WL 771897, at *9 (Del.Ch. Feb. 28, 2013) ("[w]hen directors are not seeking shareholder action, a breach of their fiduciary duty may occur if they 'knowingly disseminate false information' or deliberately misinform shareholders"); *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 990 (Del. Ch. 2007) ("the willingness of certain directors to issue Form 10-Ks that, allegedly, materially misrepresented the nature of benefits provided to [the CEO are] egregious enough that the directors involved are likely to face personal liability [for breach of the fiduciary duty of loyalty]").

⁶⁰ See PX 21, February 10, 2016 Shareholder Letter at 4.

⁶¹ *Id.* at 2 (emphasis added).

However, less than two months later, Tesla revealed it had missed its guidance of 16,000 deliveries, instead delivering just 14,820 vehicles in the 2016 Q1.⁶² Tesla blamed the lower deliveries on production constraints, specifically “severe Model X supplier parts shortages in January and February.”⁶³

This explanation is implausible. It directly contradicts Tesla’s assurances in the February 10, 2016 Shareholder Letter, which specifically addressed Model X production issues and assured investors that the Company was “significantly increasing” Model X production. It is inconceivable that, when updating shareholders halfway through the 2016 Q1, Tesla did not know of any residual problems involving Model X parts shortages. When viewed together with Tesla’s other inconsistent statements discussed herein, the inference is that Tesla simply fabricated the production issues to explain away poor sales.

2. Tesla’s Explanations For Missed Deliveries In 2016 Q2 Are Implausible And Contradict The Company’s Prior Statements

The inference that Tesla fabricated production issues is bolstered by events in the following quarter. On May 4, 2016, nearly halfway through the 2016 Q2, Tesla forecasted that it would manufacture 20,000 vehicles in the 2016 Q2 and

⁶² See PX 23, April 4, 2016 Announcement; PX 24, May 4, 2016 Shareholder Letter at 3 (revising figure to 14,810 vehicles).

⁶³ PX 23, April 4, 2016 Announcement.

deliver 17,000 vehicles.⁶⁴ However, as in the 2016 Q1, Tesla again missed its deliveries forecast. On July 3, 2016, Tesla announced that it produced 18,345 vehicles in the 2016 Q2, but that deliveries were lower than anticipated at only 14,370 vehicles.⁶⁵ The 2016 Q2 deliveries missed the Company's prior forecast of 17,000 deliveries by over 15%. Reflecting its desire to avoid scrutiny of this result, Tesla announced the missed deliveries on the Sunday of the Fourth of July holiday weekend.

Tesla again blamed production issues for the missed deliveries in the 2016 Q2. Tesla claimed that, because of an "extreme production ramp in Q2," "almost half of the quarter's production occurred in the final four weeks." As a result, there were 5,150 of these vehicles manufactured late in the quarter that were still on trucks and ships en route to customers.⁶⁶ As with the Company's explanation for missed deliveries in the 2016 Q1, Tesla's explanations for the miss in the 2016 Q2 are implausible.

In the first place, Tesla did not need any "extreme production ramp" in order to achieve the forecast of 17,000 vehicles, because Tesla began the 2016 Q2 with a production rate that *already exceeded 17,000 vehicles per quarter*. Specifically, in the 2016 Q1, Tesla produced a total of 15,510 vehicles, comprising 12,851 Model

⁶⁴ PX 24, May 4, 2016 Shareholder Letter at 3.

⁶⁵ PX 26, July 3, 2016 Announcement.

⁶⁶ *Id.*

S vehicles and 2,659 Model X vehicles. Therefore, Tesla exited the 2016 Q1 with a production rate of *at least* 15,510 vehicles per quarter.⁶⁷

Based on Tesla's statements, the Company in fact exited the 2016 Q1 with a significantly higher production level. According to Tesla's April 4, 2016 Announcement, once the Model X supplier parts shortages in January and February were resolved, "delivery rates improved dramatically." As a result, "[b]y the last full week of March, the build rate rose to 750 Model X vehicles per week."⁶⁸ This build rate of 750 Model X vehicles per week equates to **9,750** Model X vehicles per quarter. Substituting the actual 2016 Q1 production figure of 2,659 Model X vehicles with this end-of-quarter production of 9,750 vehicles per quarter, Tesla's production capacity across all vehicles at the end of the 2016 Q1 was already in excess of 22,000 vehicles per quarter, or *7,300 vehicles per month*.

Thus, Tesla's explanation of an "extreme production ramp" in the last month of the 2016 Q2 appears to be false. Tesla's reported production of 18,345 vehicles in the 2016 Q2 falls well within the 22,000 quarterly production capacity with which Tesla began the 2016 Q2. It would have been unnecessary for Tesla to have an "extreme production ramp" in order to hit the 2016 Q2 production total.

⁶⁷ PX 24, May 4, 2016 Shareholder Letter at 2.

⁶⁸ PX 23, April 4, 2016 Announcement.

In addition, crediting Tesla’s explanation that almost half of the 2016 Q2 production (18,345 vehicles) was achieved in the last month of the quarter (June) would imply that half (or approximately 9,000 vehicles) was produced by Tesla in the two months of April and May, or a monthly production of just 4,500 vehicles. This rate would have been less than the average monthly production of 5,170 vehicles in the preceding 2016 Q1, and significantly lower than the rate of 7,300 vehicles per month Tesla was capable of producing entering the 2016 Q2.

Furthermore, the explanation of an “extreme production ramp” contradicts *two* prior Company announcements *during the 2016 Q2*. In the April 4, 2016 Announcement, made at the beginning of the 2016 Q2, Tesla stated “production is now on plan,” and did not mention a need for an “extreme production ramp” in the last month of the quarter.⁶⁹ In the May 4, 2016 Shareholder Letter – disseminated nearly *halfway through the 2016 Q2* – Tesla forecasted that it could manufacture *20,000* vehicles in the 2016 Q2 and deliver *17,000* vehicles.⁷⁰ Again, Tesla never mentioned that there had been any production issues in April or May, or that there would need to be “an extreme production ramp” in the last month of June. In fact, Tesla’s shareholder letter suggested the exact opposite. Tesla expressly stated that the forecast of 17,000 deliveries already accounted for the effects of any late-in-

⁶⁹ *Id.*

⁷⁰ PX 24, May 4, 2016 Shareholder Letter at 3.

the-quarter production. Specifically, Tesla stated that “*Due to a large number of vehicles in transit to customers in Europe and Asia at end of quarter*, Q2 deliveries are expected to be approximately 17,000 vehicles.”⁷¹

Once again, when viewed together with Tesla’s other inconsistent or implausible statements discussed herein, there is a credible basis for inferring that Tesla misled shareholders concerning the existence of an “extreme production ramp,” and that this was fabricated by Tesla to mask faltering delivery (sales) figures.

D. There Is A Credible Basis To Infer That Tesla Misled Shareholders In The Prior Years 2014 And 2015

The above credible basis for suspecting wrongdoing in Tesla’s reporting of production and production constraints is strengthened by similar, unexplained discrepancies in Tesla’s explanations for missed production and/or missed deliveries in the prior years, 2014 and 2015.

Although Tesla has repeatedly advised shareholders in the past that the Company is operating at capacity and has been capacity-constrained, Tesla’s reported production is inconsistent with a company operating at capacity. Instead of reporting steadily increasing production and delivery numbers from quarter to quarter, which would be consistent with a Company operating at capacity, Tesla has reported large fluctuations in production from quarter to quarter. As detailed

⁷¹ *Id.* (emphasis added).

below, the inference is that Tesla in fact has *excess capacity* and that Tesla has *manipulated* its level of production, including *withholding* production capacity when necessary, to match the level of production with the amount of anticipated sales in any given quarter.

1. There Are Significant Unexplained Discrepancies In Tesla's Reported Production And Deliveries For The 2014 Q3

For the 2014 Q3, Tesla stated that it planned to produce 9,000 vehicles and to deliver 7,800 vehicles.⁷² On November 5, 2014, Tesla announced that it delivered 7,785 vehicles in 2014 Q3, consistent with the prior guidance of 7,800 vehicles.⁷³ However, Tesla produced only 7,200 vehicles – 1,800 less than the 9,000 guidance.⁷⁴

Tesla blamed the low production figure on a planned factory retooling shutdown taking two weeks longer than expected.⁷⁵ The problem with this explanation is that Tesla previously foreshadowed the effects of the shut-down. In the July 31, 2014 Shareholder Letter, Tesla indicated it anticipated a *two-week* retooling shutdown, which would affect *both* manufacturing and deliveries by 1,700 to 2,000 vehicles.⁷⁶ If the Company did, in fact, experience a *four-week*

⁷² PX 5, July 31, 2014 Shareholder Letter 4.

⁷³ PX 6, November 5, 2014 Shareholder Letter at 1.

⁷⁴ PX 7, November 5, 2014 Conference Call at 6.

⁷⁵ PX 6, November 5, 2014 Shareholder Letter at 2.

⁷⁶ PX 5, July 31, 2014 Shareholder Letter at 4.

retooling shutdown (two more weeks than anticipated), it is logical that not only *production* but also *deliveries* would be equally, negatively impacted. However, deliveries were not impacted at all by the additional two weeks of shutdown, coming in at 7,785 vehicles, consistent with guidance of 7,800 deliveries. Nor do later quarters evidence any impact on deliveries from the retooling shutdown.

Thus, there is a credible basis for inferring that Tesla's manufacturing capacity was greater than the 7,200 vehicles, and that Tesla may have deliberately held back production or falsely claimed the existence of production constraints in order to more closely match the production figures with the slowing delivery numbers.

2. There Are Further Significant Unexplained Discrepancies In The Company's Reported Production And Deliveries For The 2014 Q4

Reinforcing Plaintiff's credible basis for questioning the truthfulness of the Company's explanations for the 2014 Q3 production figures, Tesla reported in the following quarter, the 2014 Q4, that its production increased by a staggering **61%** to 11,627 vehicles.⁷⁷ The sheer magnitude of this increase in just one quarter supports, for several reasons, the inference that Tesla has misled shareholders concerning its production and production capacity.

⁷⁷ PX 9, February 11, 2015 Shareholder Letter at 1.

First, the record 11,627 quarterly production number conveniently allowed Tesla to meet its much-touted production guidance of 35,000 vehicles in 2014, which was announced on July 31, 2014 and affirmed on November 5, 2014. The ability to increase production by 61% quarter-over-quarter to hit this important 35,000 milestone raises further questions as to whether Tesla had the capacity to produce more cars all along in the prior quarter.

Indeed, some analysts have observed that, in the 2014 Q4, Tesla was observed to be manufacturing vehicles at a rate even higher than the reported quarterly production of 11,627 vehicles. At least one analyst has estimated that, during the 2014 Q4, Tesla's Fremont factory was manufacturing about 1,200 to 1,250 cars per week (equivalent to a total 2014 Q4 production capacity of 15,728 to 16,383 vehicles).⁷⁸

Second, reinforcing the suspicion that Tesla has more production capacity than it can sell is the fact that Tesla was only able to deliver 9,834 vehicles in the 2014 Q4, nearly 2,000 vehicles (or over 15%) less than the production figure. This supports the inference that, on the one occasion the Company needed to report a higher quarterly production figure (in order to hit the 35,000 vehicle milestone), it did so, but with the risk that it could not actually deliver all these vehicles.

⁷⁸ See PX 8, Ben Levisohn, *Tesla Motors: "Demand Continues to Outstrip Supply,"* BARRON'S (December 19, 2014).

Third, Tesla's explanation for why it could not sell all these record number of manufactured cars raises even more suspicion. To explain away the large 2,000 vehicle discrepancy between production and deliveries in the 2014 Q4, Tesla asserted that those cars could not be delivered because of "customers being on vacation, severe winter weather and shipping problems (with actual ships). As a result, about 1,400 vehicles slipped December and were delivered in Q1."⁷⁹

However, Tesla used virtually the same excuse two years before, in the 2012 Q4, when it also blamed its lack of deliveries in the 2012 Q4 on the holiday season,⁸⁰ *which explanation has now been demonstrated to be false*. As has been recently revealed, "during the latter stages of 2012 [] Tesla did have a large number of reservations in which people put \$5,000 down for the right to buy a Model S and get in the purchase queue. But the company had struggled to turn these reservations into actual sales."⁸¹ According to Vance, in a separate article published by *Bloomberg*, "Tesla's first customers were prototypical early adopters who wanted a computer on wheels. By the end of 2012, many were grumbling about the bugs still to be worked out, and sales slowed to a trickle."⁸² The real

⁷⁹ PX 9, February 11, 2015 Shareholder Letter at 1.

⁸⁰ PX 2, February 20, 2013 Shareholder Letter at 1.

⁸¹ PX 15, Ashlee Vance ("Vance"), *ELON MUSK: TESLA, SPACE X AND THE QUEST FOR A FANTASTIC FUTURE*, HarperCollins (2015) at 304.

⁸² *See* PX 13, Ashlee Vance, *Elon Musk Had a Deal to Sell Tesla to Google in 2013*, *BLOOMBERG*, April 20, 2015 at 2 (emphasis added).

reason for the deliveries shortfall in the 2012 Q4 was thus a lack of demand. In early 2013, demand for Tesla's cars had fallen so significantly that it threatened Tesla's survival as a standalone company, causing a "death spiral of missed sales targets and falling shares."⁸³

Fourth, the large 2,000 gap between production and deliveries in the 2014 Q4 directly contradicts Tesla's prior statements. Earlier in May 2014, Tesla advised shareholders that, over the course of future quarters, the difference between the number of cars delivered and the number of cars produced would *decrease*.⁸⁴ This makes sense, because even though some newly manufactured cars in the current quarter will always be in transit and be sold in the next quarter, the current quarter will also benefit from the delivery of cars manufactured in the prior quarter, resulting in a wash over time. At the time, Tesla was forecasting deliveries of 7,500 vehicles in the 2014 Q2, and production of between 8,500 and 9,000 cars – a gap of between 1,000 and 1,500 cars. Instead of declining, however, Tesla reported a larger gap of 2,000 vehicles two quarters later in the 2014 Q4.

Therefore, there is a credible basis to infer that: in the 2014 Q3 and Q4, Tesla had more manufacturing capacity than it disclosed to shareholders; in order to hit a production milestone of 35,000 vehicles a year, it deployed some of this

⁸³ *Id.*

⁸⁴ PX 4, May 7, 2014 Shareholder Letter at 4 (“[t]he quarterly gap between production and deliveries is expected to decline in future quarters”).

excess capacity in the 2014 Q4; but, reflecting the real level of demand, Tesla could not sell all of these vehicles; and, to forestall questions about demand for its cars, Tesla made materially false and misleading statements falsely claiming the existence of delivery problems.

3. There Are Further Significant Unexplained Discrepancies In The Company's Reported Production And Deliveries For The 2015 Q1

When reporting the 2014 Q4 results on February 11, 2015, Tesla also issued guidance for production of just 10,000 vehicles for the 2015 Q1 – *14% less* than the 11,627 vehicles the Company had just reported producing in the 2014 Q4. Tesla explained that the reasons for this 14% drop was “due to [the 2015 Q1] being a shorter quarter than in Q4 [2014] and approximately a week of factory downtime to allow the workforce to rest and tooling upgrades.”⁸⁵

These explanations are questionable for two reasons. First, the 2015 Q1 is only shorter than the 2014 Q4 by two days (90 days as opposed to 92 days), not one week.

⁸⁵ PX 9, February 11, 2015 Shareholder Letter at 4.

Second, Tesla's explanation of the need to give workers a one week "rest" and to conduct retooling are dubious because Tesla and Musk used *the identical explanations* in early 2013,⁸⁶ *which explanation has now been revealed to be false.*

According to Vance:

By the middle of February 2013, Tesla had fallen into a crisis state. If it could not convert its reservations into purchases quickly, its factory would sit idle, costing the company vast amounts of money. And if anyone caught wind of the factory slowdown, Tesla's shares would likely plummet, prospective owners would become even more cautious, and the short sellers would win.⁸⁷

The crisis worsened so much that Musk approached Google to see if it was interested in buying Tesla:

During the first week of April, Musk reached out to his friend Larry Page at Google. According to people familiar with their discussion, Musk voiced his concerns about Tesla's ability to survive the next few weeks. Not only were customers failing to convert their reservations to orders at the rate Musk hoped, but existing customers had also started to defer their orders as they heard about upcoming features and new color choices. *The situation got so bad that Tesla shut down its factory. Publicly, Tesla said it needed to conduct maintenance on the factory, which was technically true, although the company would have soldiered on had the orders been closing as expected.*⁸⁸

⁸⁶ PX 2, February 20, 2013 Shareholder Letter at 4 (“[w]e expect to start the year with about 4,500 deliveries in Q1, as we gave the manufacturing team the first week of the year off to celebrate their accomplishments during 2012”).

⁸⁷ PX 15, Vance, ELON MUSK: TESLA, SPACEX AND THE QUEST FOR A FANTASTIC FUTURE at 305 (emphasis added).

⁸⁸ *Id.* at 305-06.

Therefore, the inference is that, as was the case two years earlier, Tesla had more production capacity than it disclosed in the February 11, 2015 Shareholder Letter, and that it guided to a lower production number in the 2015 Q1 not because of a shorter week or worker rest, but because it was anticipating that demand would not be there to absorb the elevated levels of production – especially given the large number of unsold cars from the prior quarter. Corroborating this inference is that, on May 6, 2015, Tesla reported that, in the 2015 Q1, Tesla “manufactured 11,160 vehicles, 10% better than guidance, as we averaged more than 1,000 cars per production week.”⁸⁹ Tesla offered no explanation for this greater production.

E. Analyst Reports Questioning Whether Tesla Is Under-Reporting Its True Production Capacity Further Support A Credible Basis To Infer Tesla’s Misconduct

Several analysts have also publicly questioned the accuracy of Tesla’s statements concerning production and capacity. For example, on February 23, 2015, Bank of America Merrill Lynch analyst, John Lovallo (“Lovallo”), published a research note about Tesla, in which he cut the target price for the Company to \$65. He stated, “We have long contended that Tesla’s primary challenge is a lack of demand for its [electric vehicles].” Despite management’s bullish outlook on demand, Lovallo noted “we now know that Tesla is producing at levels that are

⁸⁹ PX 14, May 6, 2015 Shareholder Letter at 2.

both well *below past run-rates and the company's current installed capacity. In other words, Tesla appears to be pulling back on production, which we believe could create the appearance of rising demand.*"⁹⁰

Similarly, on February 12, 2015, *Seeking Alpha* published an article suggesting that Tesla appeared to have deliberately held back production in order to create the impression of capacity constraints. According to the analyst, the lower production rate "looks like a factory working below rated capacity not a factory so overwhelmed with orders that it is 'production-constrained' and can't service them all."⁹¹

More recently, Colin Michael Lagan, an analyst with UBS Securities LLC has questioned demand for the Model S: "[Y]ou indicate Model S and Model X orders are up about 65% year over year. But if we look at deliveries and production of the Model S, it hasn't changes that much since Q4. And you're rolling out the lower-priced [] version. So if demand is up so much, why offer a lower-priced model and why hasn't production really been up that much more?"⁹²

⁹⁰ PX 12, Matthew Debord, *Analyst: The bullish case for Tesla has been debunked*, Business Insider, February 23, 2015 at 1.

⁹¹ PX 11, Paulo Santos, *Why Is Tesla Throttling Production?*, Seeking Alpha, February 12, 2015 at 2.

⁹² PX 33, *Tesla Goes For Broke With Q3 Deliveries*, Seeking Alpha, August 22, 2016 at 5.

Indeed, Musk’s own internal Company statements suggest an acute awareness of public perception and public questions about demand for Tesla’s vehicles. In an August 29, 2016 e-mail, Elon Musk urged Company employees “to cut costs and deliver every car we possibly can.” He wrote, “I think it was important to write you a note directly to let you know how critical this quarter is. . . . The third quarter will be our last chance to show investors that Tesla can be at least slightly positive cash flow and profitable before the [new] Model 3 reaches full production.”⁹³

F. Recent Key Senior Executive Departures Further Support A Credible Basis For Inferring Ongoing Wrongdoing

Apart from the Company’s contradictory disclosures, and constantly shifting and implausible explanations, there is a further basis for inferring wrongdoing based on the troubling departures of key senior executives from Tesla’s finance, production and communications departments – all departments that are touched by the issues raised by Plaintiff’s investigation – in just the past year:

- June 2015: Ahuja, the Company’s chief financial officer, announced that he was retiring. Ahuja was replaced by Jason Wheeler in November 2015.⁹⁴
- January 2016: Tesla’s Chief Information Officer, Jay Vijayan, left Tesla.⁹⁵

⁹³ PX 34, Dana Hull, *Musk Urges Tesla Workers to Cut Costs Ahead of Fundraising Round*, Bloomberg, September 2, 2016 at 1, 2.

⁹⁴ PX 35, Answer No. 64.

- March 7, 2016: Ricardo Reyes, Vice President of Global Communications, left Tesla.⁹⁶
- March 24, 2016: It was reported that Michael Zanoni, Vice President of Finance and Global Controller, had departed the Company.⁹⁷
- April 1, 2016: James Chen, Tesla’s Vice President of Regulatory Affairs and Deputy General Counsel, departed the Company.⁹⁸

In May 2016, Tesla announced that Greg Reichow (“Reichow”), the Company’s Vice President of Production, was departing and would take a leave of absence after his successor was found.⁹⁹ Reichow was “the leader of car production and had been one of Tesla’s highest-compensated employees, making almost \$6.4 million in cash, stock, and options in the last two years, according to company filings.”¹⁰⁰ The timing of Mr. Reichow’s departure was unusual, given the looming launch of Tesla’s new mass-market car, the Model 3. Reichow had been expected to lead the manufacturing of that vehicle. At the same time, it was

⁹⁵ *Id.* No. 65.

⁹⁶ *Id.* No. 66.

⁹⁷ *Id.* No. 67.

⁹⁸ *Id.* No. 68.

⁹⁹ *Id.* No. 69.

¹⁰⁰ PX 25, Tom Randall, *Two Tesla Production Chiefs to Leave Ahead of Model 3 Ramp-Up*, BLOOMBERG, May 4, 2016 at 2.

reported that Josh Ensign, Vice President of Manufacturing, was also departing the Company.¹⁰¹

These departures are troubling and provide a further credible basis for inferring wrongdoing. As reported by CNBC, “[f]amed short seller Jim Chanos told CNBC that by his count, Tesla has already seen eight executives leave the company this year.... [O]ne of his firm’s ‘historical signposts of a company in trouble is when numbers of senior people leave over a short period of time.’”¹⁰² According to Chanos, “[t]he last high-profile company that we saw with such a similar large number of senior executive departures was Valeant.”¹⁰³

G. Plaintiff Has Established A Proper Purpose To Investigate Demand Futility

It is also well established that seeking books and records in an effort to establish demand futility is a proper purpose under Section 220.¹⁰⁴ Because Plaintiff has demonstrated a credible basis to infer mismanagement, it is also proper for Plaintiff to investigate the Board’s ability to evaluate a Rule 23.1 demand prior to commencing potential derivative litigation.

¹⁰¹ *Id.* at 1.

¹⁰² PX 27, Christine Wang, *Short Seller Chanos Says Tesla Sure Does Remind Him Of Valeant*, CNBC, July 6, 2016 at 1.

¹⁰³ *Id.*

¹⁰⁴ *See, e.g., Meltzer v. CNET Networks, Inc.*, 934 A.2d 912, 913 (Del. Ch. 2007) (permitting stockholder access to books and records generated before plaintiff owned stock so plaintiff could obtain particularized facts they need to adequately allege demand futility).

II. THE BOOKS AND RECORDS PLAINTIFF SEEKS ARE NECESSARY AND ESSENTIAL TO FULFILL PLAINTIFF'S PURPOSE

A. Stockholders May Inspect All Documents Necessary To Their Purpose

Once a stockholder has established a proper purpose, the stockholder “should be given access to *all* of the documents in the corporation’s possession, custody or control that are necessary to satisfy that proper purpose.”¹⁰⁵ Whether documents are necessary to that purpose “is fact specific and will necessarily depend on the context in which the shareholder’s inspection demand arises.”¹⁰⁶ “For this statutory tool to be meaningful, . . . it cannot be read narrowly to deprive a stockholder of necessary documents. . . . Thus, where a § 220 claim is based on alleged corporate wrongdoing, and assuming the allegation is meritorious, the stockholder should be given enough information to effectively address the problem.”¹⁰⁷ A Section 220 plaintiff may request “*categories* of books and records

¹⁰⁵ *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 114 (Del. 2002) (emphasis added).

¹⁰⁶ *Espinoza v. Hewlett-Packard Co.*, 32 A.3d 365, 371, 372 (Del. 2011).

¹⁰⁷ *Saito*, 806 A.2d at 114-15, 117 (if “activities. . .are ‘reasonably related’ to the stockholder’s interest as a stockholder, then the stockholder should be given access to records necessary to an understanding of those activities”); *see also Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW*, 95 A.3d 1264, 1271 (Del. 2014) (“[d]ocuments are ‘necessary and essential pursuant to a Section 220 demand if they address the crux of the shareholder’s purpose and if that information is unavailable from another source’”) (internal quotation marks and citation omitted).

with specific and discrete identification” but “need not . . . demand documents with pinpoint specificity.”¹⁰⁸

Here, Plaintiff seeks documents relating to his proper purpose of investigating potential mismanagement and possible breaches of fiduciary duty at Tesla. Plaintiff seeks material only from January 1, 2014 to the present (2016) – the years for which there are significant unexplained discrepancies in the Company’s production and deliveries. Plaintiff has also carefully described each category of documents essential to accomplish his proper purpose. Between the June 15, 2015 Demand and the July 18, 2016 Demand, the books and records sought by Plaintiff can be grouped into four categories:

- (i) Board and Board committee minutes and materials concerning Tesla’s vehicle production capacity, Tesla’s forecast production, Tesla’s actual production, Tesla’s capacity utilization, any purported production constraints, and Tesla’s actual deliveries (sales);
- (ii) internal reports and analyses related to Tesla’s manufacturing capacity, actual production and capacity utilization, including documents reflecting the manner by which the Company accounts for orders for Tesla’s vehicles, Tesla’s production, Tesla’s capacity, Tesla’s deliveries and sales, and Tesla’s inventory;
- (iii) books and records sufficient to support statements to investors concerning production and capacity made by Tesla in 2014-2016, including the Company’s disclosures in its shareholder letters, financial statements, proxy statements and other filings with the Securities and Exchange Commission;

¹⁰⁸ *Wynnefield Partners Small Cap Value L.P. v. Niagara Corp.*, No. Civ.A. 1261-N, 2006 WL 2521434, at *2 (Del. Ch. Aug. 9, 2006) (internal quotations omitted).

- (iv) books and records related to specific purported production constraints, such as the Company’s purported production shutdowns in 2014 Q3 and 2015 Q1, the purported supplier parts shortages experiences in January and February of 2016, and the purported “extreme production ramp” in the 2016 Q2.

As discussed below, these requests are narrowly-tailored with respect to subject matter and time, and Tesla should be required to produce them.

B. The Categories Of Documents That Plaintiff Seeks Are Necessary, Narrowly Tailored, And Consistent With Delaware Law

1. Board and Board Committee Documents

Because they constitute the official records of the corporation, board and committee meeting minutes are routinely provided for inspection in Section 220 actions.¹⁰⁹ Meeting preparation materials, such as memoranda, outlines and scripts, are also documents to which a Section 220 plaintiff is entitled when investigating corporate mismanagement.¹¹⁰

The Board and any committee materials are essential to determining: whether Tesla’s officers and directors properly discharged their duty to the

¹⁰⁹ See, e.g., *Kaufman v. CA, Inc.*, 905 A.2d 749, 751-52 (Del. Ch. 2006) (Section 220 production included “lightly redacted copies of minutes of meetings of CA’s board of directors and Audit Committee . . . summaries of the five Audit Committee interviews”); *Amalgamated Bank v. UICI*, Civ. A. 884-N, 2005 WL 1377432, at *4 (Del. Ch. 30 June 2, 2005) (plaintiff was “entitled to broad access to the [board] minutes in order to evaluate whether UICI’s directors, through their conduct as revealed in those minutes, have satisfied their fiduciary duties”).

¹¹⁰ *Kaufman*, 905 A.2d at 751-52 (Section 220 production including “talking points” prepared in connection with oral briefings to the board of directors concerning a government investigation).

Company and its stockholders; whether a derivative action is warranted; and if so, whether a pre-suit demand would be excused.

2. Internal Reports and Analyses

Plaintiff also seeks to inspect internal reports and analyses related to Tesla's production, capacity utilization, production constraints and actual deliveries. These internal reports and analyses are critical to investigate how Tesla accounts for each of these metrics, and whether Tesla did, in fact, experience capacity constraints, or whether Tesla has misled shareholders about production capacity and production numbers to hide declining demand.¹¹¹ Although Board and committee materials provide some insight, this information is routinely wiped of anything that can pose a threat of future liability. Accordingly, the Court should direct the Company to produce these internal reports and analyses.¹¹²

3. Documents Supporting Tesla's Disclosures To Shareholders

This category is similar to category 2 above, and is also critical to understanding whether Tesla did, in fact, experience production constraints. Companies routinely undergo a vetting procedure, by both inside counsel and outside counsel, when preparing communications to shareholders, which in this

¹¹¹ See, e.g., *Dobler v. Montgomery Cellular Holding Co.*, Nos. CIV. A. 18105 NC, 18499, 2001 WL 1334182 (Del. Ch. Oct. 19, 2001) (ordering defendant to produce four years' worth of "[i]nternal corporate memoranda, e-mails, letters, minutes and resolutions, or other documents").

¹¹² *Id.* at *5 ("[o]nly by viewing supporting documents" could plaintiff determine whether there were "acts of corporate waste or mismanagement").

case included press releases, shareholder letters and other SEC filings. As part of this vetting procedure, Tesla would have had to collect the necessary data from the finance department, manufacturing department and possibly other departments. Allowing Plaintiff to inspect these documents will allow Plaintiff to verify the source for all the figures reported in these shareholder communications, and the source for all the various claims as to production constraints.¹¹³

4. Books And Records Documenting Specific, Reported Production Constraints

This category is also similar to category 2 above and is critical to understanding whether Tesla did, in fact, experience capacity constraints. To the extent Tesla did experience production “shutdowns” in the 2014 Q3 and 2015 Q1, supplier parts shortages in January and February of 2016, and an “extreme production ramp” in the 2016 Q2, Tesla would have either internal communications among its senior officers (including reports), as well as external communications with suppliers, reflecting this.¹¹⁴ As the Court stated in *Saito*,

¹¹³ See, e.g., *Paul*, 2012 WL 28818, at *7 (plaintiff entitled to documents that “could impact the veracity of [the company’s] financial reporting and would help confirm or repudiate [plaintiff’s] suspicions of fraud and wrongdoing at the [c]ompany”).

¹¹⁴ See, e.g., *Wal-Mart Stores*, 95 A.3d at 1272-73 (officer-level documents are necessary and essential to determining whether and to what extent mismanagement occurred and what information was transmitted to corporation’s directors and officers); see also *Ind. Elec. Workers Pension Trust Fund IBEW v. Wal-Mart Stores, Inc.*, Del. Ch., C.A. No. 7779-CS, Strine, Jr., C. (Oct. 15, 2013) (Final Order and Judgment) (PX 3) at 4-5 (ordering Section 220 defendant to produce

“generally, the source of the documents in a corporation’s possession should not control a stockholder’s right to inspection under § 220.”¹¹⁵

III. TESLA’S AFFIRMATIVE DEFENSES IN ITS ANSWER LACK MERIT

In its Answer, Tesla raises a number of affirmative defenses that have not otherwise been discussed above. None of these affirmative defenses has merit.

First, Tesla alleges that Plaintiff is somehow “estopped” from bringing this derivative action because, in between the first June 15, 2015 Demand and the second July 18, 2016 Demand, he acquired more shares of Tesla.¹¹⁶ Tesla cites no legal or statutory authority for this sweeping proposition. Section 220 does not prohibit a shareholder from increasing its shares in a company after a books and records demand. Tesla seems to suggest that, after making the first books and records demand, the only way Plaintiff could demonstrate his concern with the Company’s misconduct was to *reduce* his shares in the company. That is absurd. Taken to its extreme, Tesla’s argument would mean that a shareholder concerned with misconduct at a company should just sell its shares completely and exit the

responsive emails of selected senior officers); *Dobler*, 2001 WL 1334182, at *6 (ordering production of four years’ worth of “[i]nternal corporate memorand[a], e-mails, letters, minutes and resolutions, or other documents”); *Saito v. McKesson*, Del. Ch., C.A. No. 18553, Chandler, C. (Sept. 20, 2002) (Order) (PX 1), *aff’d*, 818 A.2d 970 (Del. 2003) (granting inspection of communications between officers, as well as communications between management and the board).

¹¹⁵ 806 A.2d at 118-19.

¹¹⁶ PX 35, Answer, Affirmative Defense No. 1.

company – an argument completely subversive of the statutory remedy embodied in Section 220. Indeed, a shareholder’s acquisition of *more* shares after an initial books and records demand serves to demonstrate that shareholder’s bona fide interest in *benefiting* the company, and in correcting any misconduct.

Second, Tesla alleges that Plaintiff “filed suit despite Tesla’s offer to produce documents that addressed the central thesis of his demand,” and that Plaintiff “prejudged the sufficiency of that offered production” and filed this action prematurely.¹¹⁷ This affirmative defense, which relates only to Plaintiff’s July 18, 2016 Demand, is a nonsense.

In response to the July 18, 2016 Demand, Tesla’s counsel, Dean Kristy, stated that Tesla would “undertake to search for documents sufficient to address Mr. Haque’s central thesis that ‘faltering demand’ in Q1 and Q2 2016 caused the Company to ‘concoct’ production challenges.”¹¹⁸ When Plaintiff’s counsel asked Mr. Kristy two days later to explain what this vague statement meant, and to confirm whether or not Tesla would be producing the specific categories of documents identified in the July 18, 2016 Demand¹¹⁹ (*i.e.* books and records related to actual production, production capacity and utilization, and purported production constraints), Mr. Kristy’s colleague responded by email that Mr. Kristy

¹¹⁷ *Id.* Affirmative Defense No. 7.

¹¹⁸ PX 29, Tesla’s Letter to Plaintiff, dated July 25, 2016 at 8.

¹¹⁹ PX 30, Plaintiff’s Letter to Tesla, dated July 27, 2016.

was on vacation and would not be able to respond until nearly two weeks later.¹²⁰ When those two weeks came and passed without any further clarification, and in light of Tesla's prior refusal to give Plaintiff documents related to production, production capacity and production constraints in response to the June 15, 2015 Demand, Plaintiff commenced this action.

If Tesla were indeed genuine about its intention to produce documents, Tesla could do so now. It has not.

Third, Tesla alleges that Plaintiff is precluded by "laches or unclean hands" from litigating the June 15, 2015 Demand because he failed to communicate with the Company after the Company's final rejection of that demand on December 17, 2015.¹²¹ This is silly. Plaintiff continued his investigation after Tesla's December 17, 2015 rejection, which investigation culminated in the second, July 18, 2016 Demand. Also, Tesla does not explain what possible communication Plaintiff should have engaged in with Tesla, given that Tesla had already issued a final rejection of the Plaintiff's demand. Nor does Tesla identify the *prejudice* caused to Tesla, an essential predicate of the defense of laches.

¹²⁰ PX 31, Email from Tesla's counsel, dated July 27, 2016.

¹²¹ PS 35, Answer, Affirmative Defense No. 10.

Fourth, Tesla alleges that Plaintiff “failed to propose any confidentiality agreement.”¹²² However, Plaintiff had already entered into a confidentiality agreement in order to obtain documents in response to the June 15, 2015 Demand. Plaintiff was and remains willing to enter into the same confidentiality agreement for any documents produced in response to the July 18, 2016 Demand. If Tesla were genuine in its intention to produce, it could transmit the confidentiality agreement for signing today. It has not.¹²³

¹²² *Id.* Affirmative Defense No. 8.

¹²³ Tesla also alleges that the July 18, 2016 Demand failed to comply with the formal requirements of Section 220. PX 35, Answer, Affirmative Defense No. 9. Although Tesla does not specify the defects, based on Tesla’s July 25, 2016 response to Plaintiff’s July 18, 2016 Demand, Tesla appears to be arguing that the July 18, 2016 Demand was sent to Tesla’s counsel, not the Company’s principal place of business or registered office. This objection is baseless. Tesla was already represented by counsel after the prior June 15, 2015 Demand. Plaintiff sent the second, July 18, 2016 Demand to Tesla’s counsel as a courtesy and in order to avoid communicating directly with a represented client. Also, Tesla appears to object that, in a handwritten annotation in his verification, Mr. Haque did not initial the annotation. Again, this is silly – the annotation fixes a typographical error to correctly state the date since which Mr. Haque has continuously held shares in Tesla. The corrected date conforms with the date reflected on his brokerage statement, which Tesla was provided and has not contested. Finally, to the extent Tesla is seriously contesting any of these formalities, Tesla has waived them when it agreed to accept the July 18, 2016 Demand and “undertake to search for documents.”

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that the Court grant judgment in its favor and enter an Order requiring Tesla to permit Plaintiff and his attorneys to inspect and copy the books and records described herein, and in the June 15, 2015 Demand and July 18, 2016 Demand, and requiring Tesla to pay Plaintiff's reasonable attorneys' fees and expenses.

Respectfully submitted,

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